

3-1-1997

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### Recommended Citation

David A. Brennen, *Treasury Regulations and Judicial Deference in the Post-Chevron Era*, 13 GA. ST. U. L. REV. (1997).  
Available at: <https://readingroom.law.gsu.edu/gsulr/vol13/iss2/1>

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# TREASURY REGULATIONS AND JUDICIAL DEFERENCE IN THE POST-CHEVRON ERA

David A. Brennen<sup>†</sup>

## INTRODUCTION

1984 was a watershed year in administrative law jurisprudence in the United States. That year, the Supreme Court outlined the degree of deference courts must show to agency regulatory interpretations of statutes.<sup>1</sup> The Court concluded in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*<sup>2</sup> that an administering agency's reasonable regulatory interpretation of a statute must prevail over a differing judicial interpretation in two instances: (1) when Congress fails to unambiguously address the issue involved or (2) when the agency's interpretation is consistent with Congress' intentions.<sup>3</sup> In so doing, the Court broke new ground in administrative law by asserting that the judiciary must yield to the reasonable legal and policy determinations of an executive agency.<sup>4</sup> Despite contrary assertions,<sup>5</sup> the *Chevron* directive

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1. When this Article refers to an agency's "regulatory" interpretations, it is a reference to the agency's interpretations set forth in the regulations promulgated by that agency. Conversely, "nonregulatory" interpretations are agency interpretations contained in agency pronouncements other than the agency's regulations.

2. 467 U.S. 837 (1984).

3. *Id.* at 843.

4. *Id.* at 865-66.

Judges are not experts in the field, and are not part of either political branch of the Government. . . . While agencies are not directly accountable to the people, the Chief Executive is, and it is entirely appropriate for this political branch of the Government to make . . . policy choices—resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities.

*Id.*; see also Thomas W. Merrill, *Judicial Deference To Executive Precedent*, 101 YALE L.J. 969 (1992).

5. See, e.g., John F. Coverdale, *Court Review of Tax Regulations and Revenue*

remains unchanged today after more than a decade of subsequent Supreme Court rulings.

Further, the *Chevron* directive is quite appropriate given the form of governance in the United States. The role of courts is to consistently interpret the laws passed by Congress.<sup>6</sup> The role of agencies is to administer these laws to the extent permitted by Congress.<sup>7</sup> This administrative role necessarily involves some interpretation because Congress cannot be expected to anticipate all the variant issues that may arise in a particular area of law.<sup>8</sup> The *Chevron* directive outlines a workable method of allocating interpretive responsibilities between courts and agencies, which involves giving primary interpretive power to courts<sup>9</sup> and secondary interpretive power to agencies.<sup>10</sup> However, the agency's secondary power only exists when exercised in a proper format authorized by Congress.

Without question, the federal tax code is the most technical and complex of all federal statutory schemes.<sup>11</sup> Given this level of complexity, the Treasury Department, as the agency charged with administering the tax laws,<sup>12</sup> must provide seemingly

*Rulings in the Chevron Era*, 64 GEO. WASH. L. REV. 35, 57-63 (1995).

6. *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177 (1803) ("It is emphatically the province and duty of the judicial department to say what the law is."); *see also*, *Japan Whaling Ass'n. v. American Cetacean Soc'y*, 478 U.S. 221, 230 (1986) ("[O]ne of the Judiciary's characteristic roles is to interpret statutes. . .").

7. *See, e.g.*, *Dixon v. United States*, 381 U.S. 68, 73 (1965) ("The Commissioner's rulings have only such force as Congress chooses to give them. . .").

8. *See infra* notes 147-62 and accompanying text.

9. The phrase "primary interpretive power" refers to the surviving role of courts under *Chevron* to determine, in the first instance, what the language of a statute means—with an eye toward establishing its ambiguity or lack thereof.

10. The phrase "secondary interpretive power" refers to the role of agencies under *Chevron* to reasonably determine what Congress would have said in the statute if it had been informed of the issue under consideration and unambiguously addressed it.

11. *See Dobson v. Commissioner*, 320 U.S. 489, 498 (1943) (stating that the federal tax law is "so complex as to be the despair of judges"); *see also* Coverdale, *supra* note 5, at 73; Tax Executive Institute, PRESIDENTIAL CANDIDATES' TAX ADMINISTRATION PROPOSALS RAISE POLICY CONCERNS, 72 TAX NOTES 1823 (Sept. 30, 1996) ("We know from experience that the tax laws are mind-boggingly complex, and are convinced that both the tax laws and their administration can be improved.").

12. 26 U.S.C. § 7805(a) provides:

Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

endless guidance to the public on how to comply with these laws.<sup>13</sup> Because they are often regarded as equivalent to statutory law, valid Treasury regulations are the most important form of Treasury guidance.<sup>14</sup> Treasury regulations—both legislative and interpretive—are the most formal type of Treasury guidance and are clothed with congressional delegatory authority.<sup>15</sup> To the extent that these regulations are respected by reviewing courts, the public is assured that compliance with them is the same as complying with the related federal statute. However, if reviewing courts refuse to defer to Treasury regulatory interpretations of tax statutes, public confidence in the Treasury is damaged, as is its ability to administer the tax laws. Conceivably, this increases the likelihood that taxpayers will challenge Treasury regulations in court.

Analysis of several post-*Chevron* cases indicates that every major Supreme Court case since 1984 involving the validity of a Treasury regulation is consistent with *Chevron*.<sup>16</sup> Indeed, since 1984 every challenged Treasury regulation interpreting a statute in which Congress failed to address a specific tax issue has been upheld by the Court.<sup>17</sup> In fact, no Supreme Court case since 1984 could be discovered in which the Court invalidated a Treasury regulation on the grounds that it was an unreasonable interpretation of a statute.<sup>18</sup> Several post-*Chevron* Supreme Court decisions, however, rejected the Treasury's application of

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26 U.S.C. § 7805(a) (1994).

13. Among the many ways in which the Treasury fulfills this informing function is by issuing Treasury regulations, revenue rulings, private letter rulings, technical advice memoranda, and general counsel memoranda. The Treasury also provides information on tax laws via informal oral advice and by making many of its internal operating guidelines available to the public in the Internal Revenue Manual.

14. See *infra* notes 21-48 and accompanying text; see also Robert A. Anthony, *Which Agency Interpretations Should Bind Citizens and the Courts?*, 7 YALE J. ON REG. 1, 4 (1990).

The threshold issue for the court is always one of congressional intent: did Congress intend the agency's interpretation to bind the courts? The touchstone in every case is whether Congress intended to delegate to the agency the power to interpret with the force of law in the particular format that was used.

Anthony, *supra* (emphasis omitted).

15. See Anthony, *supra* note 14, at 44-46.

16. See *infra* notes 172-254 and accompanying text.

17. See *e.g.*, *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554 (1991).

18. But see *Rowan Cos. v. United States*, a pre-*Chevron* case in which the Court invalidated a Treasury regulation on the ground that it was inconsistent with Congress' clearly expressed directive. 452 U.S. 247, 263 (1981).

a tax regulation to a particular factual situation.<sup>19</sup> Additionally, there have been times when the Court failed to defer to the Treasury's non-regulatory interpretations.<sup>20</sup> However, at least with respect to Treasury regulatory interpretations, the Supreme Court's review of tax cases since 1984 has been consistent with *Chevron*.

Part I of this Article outlines the regulatory environment in which the Treasury Department operates. It discusses the authority of the Treasury to act as administrator of the tax laws, as well as the several ways that the Treasury fulfills its administrative obligation. Part II is an in-depth analysis of what this Article terms the "*Chevron* era." It contains an overview of several of the major Supreme Court cases preceding *Chevron* that involved Treasury regulatory deference and an analysis of the *Chevron* opinion. Part III focuses on the post-*Chevron* cases involving Treasury regulatory deference. It shows how the Supreme Court has abided by *Chevron* in each of its post-1984 decisions involving the validity of a Treasury regulation. Finally, it concludes that, contrary to the assertions of others, *Chevron* deference is alive and well. However, courts, especially the Supreme Court, should be more consistent at referencing *Chevron* so as to ensure continued adherence.

## I. THE TREASURY'S AUTHORITY TO ISSUE BINDING TAX REGULATIONS

### A. Introduction

Professor Robert Anthony has argued that an agency's interpretive authority should be viewed from two perspectives—the agency's authority to interpret the subject area and its authority to interpret in a particular format.<sup>21</sup> This Article focuses strictly on the Treasury's interpretations in the area of tax law and on its interpretations issued in the form of Treasury regulations. Thus, to the extent that the Treasury is authorized to issue binding interpretations of tax statutes and is also authorized to issue these binding interpretations in the form of regulations, the only remaining inquiry for deference purposes is whether the interpretation is reasonable.<sup>22</sup>

19. See, e.g., *Newark Morning Ledger Co. v. United States*, 507 U.S. 546 (1993).

20. See e.g., *United States v. Williams*, 115 S. Ct. 1611 (1995).

21. See Anthony, *supra* note 14, at 31-40.

22. Of course, this conclusion assumes that Congress has failed to unambiguously

### B. *Treasury Authority to Administer Tax Laws*

Congress has clearly delegated to the Treasury authority to interpret the revenue laws, including tax statutes. Indeed, by statute, the Secretary of the Treasury has broad supervisory authority over administration and enforcement of the tax laws.<sup>23</sup> Further, § 7805(a) of Title 26 delegates to the Secretary of the Treasury general rule-making authority to “prescribe all needful rules and regulations for the enforcement” of the tax laws.<sup>24</sup> Thus, any argument that the Treasury does not have authority to issue binding interpretations in the field of tax is difficult—if not impossible—to fathom.

### C. *Formats of the Treasury’s Binding (and Non-Binding) Interpretive Authority*

The Treasury accomplishes its delegated responsibility of comprehensive tax administration and enforcement in several formats: oral advice, letter rulings, revenue rulings, and Treasury regulations.<sup>25</sup> Each of these formats is issued with differing degrees of formality and levels of public notice. Accordingly, each format carries a differing degree of congressional authority to bind either courts or the public.<sup>26</sup> A brief review of these various

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address the specific matter to which the interpretation relates. If Congress has addressed the precise matter, then the Treasury’s interpretation probably lacks delegated legislative authority and is necessarily invalid—even without deciding if it is reasonable. *See generally* *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

23. Section 7801(a) provides: “(a) Powers and duties of Secretary. Except as otherwise expressly provided by law, the administration and enforcement of this title [title 26] shall be performed by or under the supervision of the Secretary of the Treasury.” 26 U.S.C. § 7801(a) (1994).

24. *See supra* note 12.

25. *See generally* Rev. Proc. 96-1, 1996-1 I.R.B. 8.

26. *See* Anthony, *supra* note 14, at 46:

For these formats, as always, the delegation must be sought. Where none is found or inferred, none should be presumed in any case unless, at a minimum, the agency has expressed its interpretation with finality and some formality, in a dispositive action—an action that specifies immediate legal results or that definitively ordains results for the future. The informal, or tentative, or advisory, or internal, or unpublicized interpretive expression will not ordinarily be a tool that Congress intends to implement its delegation of law-making authority. Additionally, an interpretation put forth in such a format ordinarily will not have been arrived at through a process that encompassed public or adversarial participation.

*Id.*

formats, however, reveals that Treasury regulations—both legislative and interpretive—have the force and effect of law and are necessarily binding.

### 1. *Non-regulatory Formats*

The Treasury's oral advice to taxpayers is the least formal of its administrative tools.<sup>27</sup> To obtain oral advice for preparation of a federal individual income tax return a taxpayer can pick up a telephone and dial 1-800-TAX-1040. Consistent with this lack of formality, the Treasury's oral advice means next to nothing when used as support for an argument of detrimental reliance against the Treasury.<sup>28</sup> Accordingly, the Treasury's oral advice is entitled to no deference whatsoever, especially when the advice is on the meaning of a statutory provision. Even with regard to such mundane statutory matters as calculating when a document should be filed in court,<sup>29</sup> the Treasury's oral advice is ignored not only by the courts, but also by the Treasury.<sup>30</sup>

Increasing in formality, the next type of Treasury guidance is letter rulings.<sup>31</sup> A letter ruling is a written interpretation of the tax laws issued by the Treasury via the Internal Revenue Service

27. See generally Rev. Proc. 96-1, 1996-1 I.R.B. 13, 14.

28. See 26 U.S.C. § 6404(f) (1994) (indicating that only written (not oral) advice by a Treasury officer or employee can form the basis for a claim that "any portion of any penalty or addition to tax attributable to erroneous advice furnished to the taxpayer" should be abated).

29. See, e.g., *Elgart v. Commissioner*, 72 T.C.M. (CCH) 398 (1996).

Turning to petitioners' argument that they were advised by several employees of the IRS that the date by which a petition must be filed in this case was March 14, 1996, we are unable to provide any relief for petitioners. The law is clear that erroneous legal advice rendered by employees of the IRS generally is not binding on the Commissioner. In any event, the Commissioner cannot waive the jurisdictional requirements, and jurisdiction cannot be established by estoppel.

*Id.* (citations omitted); see also *Dixon v. United States*, 381 U.S. 68 (1965). The Court stated:

In *Automobile Club of Michigan v. Commissioner*, we held that the Commissioner is empowered retroactively to correct mistakes of law in the application of the tax laws to particular transactions. He may do so even where a taxpayer may have relied to his detriment on the Commissioner's mistake. This principle is no more than a reflection of the fact that Congress, not the Commissioner, prescribes the tax laws.

*Dixon*, 381 U.S. at 72-73 (citations omitted).

30. See Rev. Proc. 96-1, 1996-1 I.R.B. 14 (providing in part that "[o]ral guidance is advisory only, and the Service is not bound to recognize it").

31. See *id.* at 12.

to one or more specified taxpayers that applies the law to a defined set of facts.<sup>32</sup> Unlike oral advice, letter rulings are conditionally binding upon the Treasury—at least with respect to the taxpayer requesting and receiving the letter ruling.<sup>33</sup> Consequently, taxpayers routinely request letter rulings from the Service prior to entering into financial or business transactions that may result in tax liability.<sup>34</sup> By having a letter ruling outlining and approving a transaction ahead of time as either tax-exempt or taxable only to a limited extent, the taxpayer at least knows the Treasury's position on the matter.

Although a letter ruling may bind the Treasury with respect to the described transaction, letter rulings cannot be relied upon by third-party taxpayers or the Treasury as legal precedent.<sup>35</sup> Nonetheless, both taxpayers and the Treasury routinely use letter rulings to support legal arguments for or against taxation in situations not described in, but similar to those described in, the letter rulings. Thus, while letter rulings technically have no precedential value, they are useful as a means of either predicting what the Service will argue on an issue or showing what position the Service has taken on an issue in the past.<sup>36</sup> Still, in no instance are reviewing courts required (as opposed to permitted) to defer to the Treasury's interpretation of a statute contained in one of its letter rulings.

Revenue rulings are the next most formal type of nonregulatory guidance issued by the Treasury.<sup>37</sup> Like letter rulings, revenue rulings also contain the Service's interpretation of the tax law as applied to the specific facts at issue.<sup>38</sup> However, revenue rulings are typically issued in relation to issues of broad concern, and are always issued by the Treasury's

32. *Id.*

33. *Id.* Letter rulings are only conditionally binding upon the Service and the taxpayer because they may be revoked or invalidated at any time prior to the issuance of a closing agreement. *Id.* A closing agreement is an agreement between the Service and a taxpayer on a specific issue or liability that is "final unless fraud, malfeasance, or misrepresentation of a material fact can be shown." *Id.*

34. *Id.* Pursuant to Rev. Proc. 96-1, § 5.01, letter rulings are generally issued in income and gift tax matters on proposed transactions and on completed transactions "if the letter ruling request is submitted before the return is filed for the year in which the transaction that is the subject of the request was completed." *Id.* at 15.

35. See 26 U.S.C. § 6110(j)(3) (1994).

36. See, e.g., *Rowan Cos. v. United States*, 452 U.S. 247, 261-62 n.17 (1981).

37. See Rev. Proc. 96-1, 1996-1 I.R.B. 13.

38. See Treas. Reg. § 601.601(d)(2) (1996).



national office.<sup>39</sup> The Treasury treats revenue rulings published in the Internal Revenue Bulletin as having precedential value.<sup>40</sup> However, unpublished revenue rulings carry no such weight.<sup>41</sup>

Similarly, many courts ascribe precedential value to revenue rulings where the situation in the ruling is substantially similar to the situation involved in the court case. The Treasury warns that taxpayers intending to rely on a revenue ruling "are cautioned against reaching the same conclusion . . . *unless the [ir] facts and circumstances are substantially the same.*"<sup>42</sup> However, because revenue rulings are interpretive only, they are not subject to the notice and comment requirements of the Administrative Procedure Act (APA).<sup>43</sup> Accordingly, while many courts see revenue rulings as having precedential value, courts generally do not ascribe any mandatory deference to the Treasury's statutory interpretations contained in revenue rulings.<sup>44</sup>

39. *See id.*

40. *See generally id.* § 601.601(d)(2)(v)(d)-(e).

(d) Revenue Rulings published in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose. No unpublished ruling or decision will be relied on, used, or cited, by any officer or employee of the Service as a precedent in the disposition of other cases.

(e) Taxpayers generally may rely upon Revenue Rulings published in the Bulletin in determining the tax treatment of their own transactions and need not request specific rulings applying the principles of a published Revenue Ruling to the facts of their particular cases. However, since each Revenue Ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. They should consider the effect of subsequent legislation, regulations, court decisions, and revenue rulings.

*Id.*

41. *See id.*

42. *Id.* (emphasis supplied).

43. *See* 5 U.S.C. §§ 551-559 (1994).

44. *See* Commissioner v. Schleier, 115 S. Ct. 2159, 2167 n.8 (1995) (quoting Davis v. United States, 495 U.S. 472, 484 (1990) for the proposition that "the Service's interpretive rulings do not have the force and effect of regulations"); *see also* Linda Galler, *Judicial Deference to Revenue Rulings: Reconciling Divergent Standards*, 56 OHIO ST. L.J. 1037 (1995) (arguing that federal courts have adopted divergent standards when it comes to deciding how much deference to give to revenue rulings, resulting in a significant split among the courts on the issue of revenue ruling deference); Linda Galler, *Emerging Standards for Judicial Review of IRS Revenue*

## 2. Regulation Formats

Finally, Treasury regulations are the most formal and important type of guidance issued by the Treasury.<sup>45</sup> Like letter rulings and revenue rulings, Treasury regulations contain interpretations of tax laws. However, unlike letter rulings, Treasury regulations are not issued to any one taxpayer; and, unlike revenue rulings, Treasury regulations—both legislative and interpretive—are issued pursuant to the APA's notice and comment procedure.<sup>46</sup> Once finalized, treasury regulations are published in the *Federal Register*.<sup>47</sup> Primarily because of this highly formalized method of issuance, Treasury regulations are accorded the highest level of deference of all Treasury interpretations. The Supreme Court views valid Treasury regulatory interpretations as the equivalent of the federal statute being interpreted, unless such an interpretation is arbitrary or capricious.<sup>48</sup>

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*Rulings*, 72 B.U. L. REV. 841, 870-76 (1992) (arguing that the Court in *Davis v. United States*, 495 U.S. 472 (1990), endorsed a new heightened standard of judicial deference for revenue rulings and spawned confusion in lower courts by not discussing *Chevron*). But see Paul L. Caron, *Tax Myopia Meets Tax Hyperopia: The Unproven Case Of Increased Judicial Deference To Revenue Rulings*, 57 OHIO ST. L.J. 637, 639-40 (1996) (challenging Professor Galler's conclusions in her second article—*Judicial Deference To Revenue Rulings: Reconciling Divergent Standards*—as based on a “hyperopic” and a “myopic” view of tax law); Paul L. Caron, *Tax Myopia, Or Mamas Don't Let Your Babies Grow Up To Be Tax Lawyers*, 13 VA. TAX REV. 517, 557-63 (1994) [hereinafter *Mamas Don't Let*] (challenging Professor Galler's conclusions in her first article—*Emerging Standards for Judicial Review of IRS Revenue Rulings*—as based on a misunderstanding of both tax and nontax principles); see also Linda Galler, *Judicial Deference to Revenue Rulings: What It's All About*, 72 TAX NOTES 769, 770 (Aug. 5, 1996) (responding to Professor Caron's criticisms as resulting from “fundamental misunderstandings” and “misinterpret[at]ions” of Galler's work).

45. See generally Treas. Reg. § 601.601(a)(1) (1996).

46. Although only legislative regulations are required to be issued pursuant to the APA's notice and comment procedure, the Treasury issues all of its regulations—legislative and interpretative—pursuant to these guidelines. See Ellen Aprill, *Muffled Chevron: Judicial Review of Tax Regulations*, 3 FL. TAX REV. 51, 57 (1996).

47. Treas. Reg. § 601.601(d) (1996).

48. See, e.g., *Batterton v. Francis*, 432 U.S. 416, 426 (1977) (“The regulation at issue in this case is therefore entitled to more than mere deference or weight. It can be set aside only if the Secretary exceeded his statutory authority or if the regulation is ‘arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law’”).

II. THE *CHEVRON* ERAA. *Introduction to the Chevron Era*

In the fourteen years prior to the *Chevron* decision in 1984, the Supreme Court issued several decisions that passed on the validity or invalidity of Treasury regulations.<sup>49</sup> Each of these pre-*Chevron* tax cases was decided in a legal environment that was devoid of a comprehensive deference methodology. At that time, the Court had no uniform procedure for evaluating whether its own determination, or that of an administering agency, should control when deciding how to interpret a federal tax statute.<sup>50</sup> Instead, the Court used a hodge-podge of factors to determine how much weight the judiciary should give agency interpretations. These factors included the expertise of the agency, the technical complexity of the subject matter, the consistency of the agency in expressing its view and the amount of time between enactment of the statute and issuance of the rule or regulation.<sup>51</sup> However, prior to *Chevron*, the Court did not mandate that the judiciary must defer to an agency's interpretation of a statute.<sup>52</sup>

The *Chevron* decision changed this approach to deference by ushering in an element of certainty, at least in terms of methodology, into an otherwise uncertain area. With the *Chevron* decision, less attention is given to the "weight" of factors and more attention is given to how and when the factors are weighed.<sup>53</sup> Thus, without regard to how a court would have decided a pre-*Chevron* case, that decisional process is necessarily changed to the extent that *Chevron* mandates a court to defer to

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49. See, e.g., *Dickman v. Commissioner*, 465 U.S. 330 (1984); *United States v. Vogel Fertilizer Co.*, 455 U.S. 16 (1982); *Rowan Cos. v. United States*, 452 U.S. 247 (1981); *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504 (1981); *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472 (1979); *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979); *Central Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21 (1978); *Fulman v. U.S.*, 434 U.S. 528 (1978); *Commissioner v. Standard Life & Accident Ins. Co.*, 433 U.S. 148 (1977); *California Bankers Ass'n v. Shultz*, 416 U.S. 21 (1974); *United States v. Cartwright*, 411 U.S. 546 (1973).

50. See Anthony, *supra* note 14, at 6 ("No pre-*Chevron* case articulated a consistent or comprehensive statement of doctrine, like that ventured in *Chevron*, on the appropriate measure of judicial deference to agencies.").

51. See, e.g., *National Muffler*, 440 U.S. at 477; see Coverdale, *supra* note 5, at 42.

52. See Anthony, *supra* note 14, at 6 ("But the pre-*Chevron* cases were habitually unclear in indicating the point at which the weight or deference due would compel a court to accept the agency interpretation.").

53. *Chevron*, 467 U.S. at 844-45.

the agency. Simultaneously, however, the *Chevron* decision left much of the substance of pre-*Chevron* administrative jurisprudence intact.<sup>54</sup> This point is reflected in *Chevron's* failure to specifically disavow or overrule any of the pre-*Chevron* cases.<sup>55</sup>

### B. Pre-Chevron

Reviewing the pre-*Chevron* tax decisions provides some insight into the Court's focus when deciding a deference issue prior to 1984. This judicial focus reveals that pre-*Chevron* Treasury regulations interpreting terms not already defined by statute were likely to be upheld by the Supreme Court as valid.<sup>56</sup> Conversely, Treasury regulations interpreting terms already defined by Congress—either in the statute or through legislative history—were less likely to survive Supreme Court scrutiny.<sup>57</sup> Thus, the absence or presence of a congressional definition of a term that the Treasury interpreted and defined by regulation was often critical to deciding if the regulation was valid.<sup>58</sup>

#### 1. Challenged Regulation Upheld: Congress Did Not Define the Term by Statute

The defining case of the pre-*Chevron* era in which the Supreme Court outlined appropriate standards for judicial review of Treasury regulations is *National Muffler Dealers Assoc'n v. United States*.<sup>59</sup> From *National Muffler*, it is quite evident that, before *Chevron*, a Treasury regulatory interpretation of a statute was upheld as valid whenever the Court determined that the Treasury's interpretation was not inconsistent with Congress' expressed intentions.

*National Muffler* involved the validity of Treasury Regulation section 1.501(c)(6)-1,<sup>60</sup> which defined the term "business league"

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54. *E.g.*, Anthony, *supra* note 14, at 15 ("This broad structure [of the pre-*Chevron* cases] continues after *Chevron*.").

55. *But see infra* notes 158-60 (discussing the theory that the Court, with *Chevron*, failed to continue the practice of distinguishing legislative and interpretive regulations).

56. *See infra* notes 59-87 and accompanying text.

57. *See infra* notes 88-124 and accompanying text.

58. *But c.f.* Anthony, *supra* note 14, at 14-15.

59. 440 U.S. 472 (1979).

60. *Id.* at 474. Treasury Regulation § 1.501(c)(6)-1 provides:

as used in section 501(c)(6) of the Code.<sup>61</sup> The taxpayer, a franchisee association of Midas Muffler, sued the Commissioner for refund of federal income taxes, alleging that the Commissioner improperly denied the association tax-exempt "business league" status.<sup>62</sup>

The Supreme Court concluded that Treasury Regulation section 1.501(c)(6)-1 was valid.<sup>63</sup> The Court reasoned that, because "business league" had "no well-defined meaning or common usage" outside of tax law, the term most appropriately lent itself to a Treasury regulatory interpretation.<sup>64</sup> Under such circumstances, "if [the regulation was] found to 'implement the congressional mandate in some reasonable manner,' " it was upheld.<sup>65</sup> One purpose of the congressional mandate supporting the "business league" exemption was to exempt organizations primarily purposed to promote general business welfare.<sup>66</sup> Thus, the Treasury's conclusion that section 501(c)(6) "business leagues" should work towards "improvement of business

A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. . . . A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax.

Treas. Reg. § 1.501(c)(6)-1 (1996).

61. Section 501(c)(6) exempts the following from the federal income tax: "[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual." 26 U.S.C. § 501(c)(6) (1994).

62. *National Muffler*, 440 U.S. at 473-75. The district court denied the association's refund request, concluding that the Midas franchisees did not constitute a "line of business" under Treasury Regulation § 1.501(c)(6)-1. *Id.* The Court of Appeals affirmed, concluding that Congress provided no contrary guidance in the statute. The appellate court reasoned that the Treasury's "line of business" requirement was consistent with the congressional intention that the exemption apply to "organizations which promote some aspect of the general economic welfare rather than support particular private interests." *Id.* at 475-76 (citation omitted). Accordingly, imposing a "line of business" requirement was the Treasury's means of ensuring promotion of some aspect of the general economic welfare. *Id.*

63. *Id.* at 489.

64. *Id.* at 476.

65. *Id.* (citation omitted).

66. *Id.* at 480-82.

conditions or to the promotion of the general objects of one or more lines of business” was consistent with congressional intention.<sup>67</sup>

Noticeably absent from the *National Muffler* decision is any discussion of a requirement that the Court abide by the Treasury’s decision in its regulatory interpretation of section 501(c)(6). Indeed, the Court “deferred” to the agency because it was appropriate given the circumstances, namely, an absence of a congressional definition of “business league” and the consistency of the Treasury’s interpretation with the general purposes of the statute.<sup>68</sup> This substantive element of judicial deference to agency interpretations still exists today.<sup>69</sup>

Another pre-*Chevron* case in which the Supreme Court upheld the validity of the Treasury’s regulatory interpretation of a statute is *Fulman v. United States*.<sup>70</sup> In *Fulman*, a taxpayer<sup>71</sup> unsuccessfully challenged the Treasury’s regulatory interpretation of a dividend valuation statute.<sup>72</sup> The issue was whether the Treasury’s regulatory determination regarding valuation of appreciated property distributed as a deficiency dividend by a personal holding company<sup>73</sup> was valid.<sup>74</sup> The

67. *Id.* at 482 (quoting Treas. Regs. 74, art. 528 (1929)).

68. *Id.* at 481-84.

69. See *infra* notes 173-255 and accompanying text.

70. 434 U.S. 528 (1978).

71. *Id.* The taxpayer was actually the successor corporation to a personal holding company. However, for ease of reference, “taxpayer” is used to refer to both the successor and the predecessor companies. *Id.* at 531-32.

72. *Id.* at 529.

73. *Id.* A § 542 personal holding company was described generally as any corporation having at least 60% of its adjusted ordinary gross income consisting of personal holding company income and 50% of whose stock value was owned by five or fewer individuals during the last half of the year. *Id.* at 531 n.5. Per § 542(c), corporations such as banks, life insurance companies, surety companies, certain lending or finance companies, § 501 tax-exempt organizations, and others are categorically excluded from the personal holding company definition. 26 U.S.C. § 542(c) (1994). Pursuant to § 543, personal holding company income generally consisted of dividends, rents and royalties. *Fulman*, 434 U.S. at 531 n.5.

74. *Fulman*, 434 U.S. at 529. The Commissioner first assessed a § 541 personal holding company tax against the taxpayer, which (pursuant to § 541) was equal to 39.6% of undistributed personal holding company income. *Id.* at 531-32. Then, pursuant to § 547, the Commissioner permitted the taxpayer to make “deficiency dividend” payments to its shareholders to reduce or eliminate the amount of personal holding company tax owed. *Id.* at 532. Accordingly, the taxpayer distributed shares of stock held in other companies to its shareholders as deficiency dividends. *Id.*

taxpayer claimed a deficiency dividend deduction for the fair market value of shares distributed to its shareholders.<sup>75</sup>

Pursuant to section 562 of Title 26 and Treasury Regulation section 1.562-1(a), the Commissioner disallowed the taxpayer's claimed deduction to the extent that it exceeded the adjusted basis of the stock distributed.<sup>76</sup> Section 562 provided that "dividends" eligible for the dividends paid deduction include "only dividends described in § 316."<sup>77</sup> Treasury regulation section 1.562-1(a) provided that dividends paid in property other than money were valued at "the adjusted basis of the property in the hands of the distributing corporation at the time of the distribution."<sup>78</sup> Thus, the taxpayers attempt to value the stock dividend at fair market value clearly conflicted with the Treasury's regulatory interpretation of section 562's definition of "dividends" eligible for deduction.<sup>79</sup>

The Supreme Court concluded that the Treasury's regulatory interpretation of section 562 was reasonable.<sup>80</sup> The Court noted that Congress failed to address the valuation issue under then-current law.<sup>81</sup> Thus, while the pre-1954 personal holding company statute clearly indicated that "adjusted basis" was the proper corporate valuation method,<sup>82</sup> Congress expressed no

75. *Id.*

76. *Id.*

77. *Id.* at 529 n.1 (quoting 26 U.S.C. § 562 (1954)). Section 561(b) provides that, "[i]n determining the deduction for dividends paid, the rules provided in section 562 (relating to rules applicable in determining dividends eligible for dividends paid deduction) . . . shall be applicable." *Id.* (quoting 26 U.S.C. § 561 (1954)).

78. *Id.* at 529 n.1 (quoting Treas. Reg. § 1.562-1 (1977)).

79. *Id.* at 529-30. After paying the additional personal holding company tax assessed because of the reduction of the deduction, the taxpayer filed a claim for refund. *Id.* at 532. The Commissioner denied the taxpayer's refund request. The taxpayer then sought judicial review of the Commissioner's refund denial in federal district court, but both the federal district court and the First Circuit Court of Appeals affirmed the Commissioner's refund denial and the validity of the Treasury's regulatory interpretation of § 562. *Id.*

80. *Id.* at 538-39.

81. *Id.* at 538.

82. *See id.* at 536-37. The Court writes:

In the Revenue Act of 1936, Congress enacted a surtax on undistributed profits intended to supplement the 1934 enactment of the personal holding company tax. In § 27(c) of the 1936 Act, 49 Stat. 1665, later codified as § 27(d) of the Internal Revenue Code of 1939, 53 Stat. 20, Congress expressly provided the "adjusted basis" measure for valuation with respect to the distributing corporation of dividends paid in appreciated property rather than money:

opinion in the post-1954 statute as to how to value these dividends.<sup>83</sup> Therefore, the Treasury's interpretation of Congress' ambiguous legislative silence was appropriate and reasonable and evidenced no "weighty reasons" that would justify setting aside the [regulation]."<sup>84</sup>

Notably, the Supreme Court rejected the taxpayer's claim that its own statutory interpretation, and that of another court, should be followed because it was more reasonable than the

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If a dividend is paid in property other than money . . . the dividends paid credit with respect thereto shall be the adjusted basis of the property in the hands of the corporation at the time of the payment, or the fair market value of the property at the time of the payment, whichever is the lower.

Although this section may not have been enacted with the personal holding company tax primarily in mind, § 351(b)(2)(C) of the 1936 Act nonetheless expressly provided that the dividends-paid credit for that tax would be governed by § 27(c). At the same time, in contrast, the 1936 Act provided that property distributed as a dividend would be valued with respect to distributees at its fair market value.

*Id.* at 536-37 (citation omitted).

83. *See id.* at 537-38. The Court further stated:

Nor can Congress' failure to re-enact a counterpart to § 27(c) in the 1954 Code be read unambiguously to indicate that Congress had abandoned the "adjusted basis" measure in favor of the "fair market value" measure. In describing the purpose of § 562(a), which defines dividends eligible for deduction for personal holding company tax purposes, the Senate Finance Committee explained:

Subsection (a) provides that the term 'dividend' for purposes of this part shall include, except as otherwise provided in this section, only those dividends described in section 316. . . . The requirements of sections 27(d), (e), (f), and (i) of existing law [Internal Revenue Code of 1939, as amended] are contained in the definition of 'dividend' in section 312, and accordingly are not restated in section 562.

The Report of the House Ways and Means Committee is *in haec verba*, except that it says that the requirements of §§ 27(d), (e), (f), and (i) are contained in what is now § 316 of the 1954 Code. The discrepancy between the House and Senate Reports is not material, however, since, as we have explained, there is no way to reach the result of § 27(c) by following any path through the language of the 1954 Code. In light of the failure of the language of the Code to create the result of § 27(c), the statement in the House and Senate Reports could be read to indicate that Congress meant to incorporate only so much of § 27 as was actually enacted—that is, none of it. But this meaning is not compelled, and we cannot say that the language of the Reports cannot be read to evince Congress' intention, albeit erroneously abandoned in execution, to retain the "adjusted basis" valuation rule of § 27(c).

*Id.* (citations omitted).

84. *Id.* at 539.



Treasury's.<sup>85</sup> The taxpayer argued that personal holding company dividends should be valued in the same manner for both the distributing corporation and the distributee shareholder.<sup>86</sup> While acknowledging the logic and reasonableness of the taxpayer's argument, the Court noted that the Treasury's reasonable regulatory interpretation should prevail—even in the face of the taxpayer's equally reasonable alternative interpretation.<sup>87</sup> Thus, even in the pre-*Chevron* era, the Court recognized the strength of the Treasury's reasonable regulatory interpretations, especially where Congress has failed to provide statutory guidance.

## 2. *Challenged Regulation Invalidated: Congress Defined the Term in the Statute*

*United States v. Vogel Fertilizer Co.*,<sup>88</sup> is one of the few pre-*Chevron* cases in which the Supreme Court invalidated the Treasury's regulatory interpretation of a federal statute.<sup>89</sup> *Vogel* involved the Treasury's regulatory interpretation of the term "brother-sister controlled group," as used in § 1563(a)(2) of Title 26.<sup>90</sup> According to the Code provision, a "brother-sister controlled group" consisted of:

Two or more corporations if 5 or fewer persons . . . own . . . stock possessing—(A) at least 80 percent of the total combined voting power . . . or at least 80 percent of the total value . . . of each corporation, and (B) more than 50 percent of the total combined voting power . . . or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of

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85. *See id.* at 532.

86. *See id.* at 534-36.

87. *Id.*; *see also* National Muffler Dealers Ass'n v. United States, 440 U.S. 472, 488 (1979). ("The choice among reasonable interpretations is for the Commissioner, not the courts.")

88. 455 U.S. 16 (1982).

89. *Id.* at 22.

90. *Id.* at 18-19. In *Vogel*, the taxpayer was a corporation whose major individual shareholder owned more than three-fourths of all its outstanding common shares. *Id.* at 19-20. The remaining shares were owned by one other individual. The taxpayer's major shareholder also owned about 90% of the stock of another corporation, Vogel Popcorn Co. The taxpayer's minority stockholder owned no shares of Vogel Popcorn. *Id.* at 19-21.

each such person only to the extent such stock ownership is identical with respect to each such corporation.<sup>91</sup>

The Treasury further interpreted the term "brother-sister controlled group" in regulation section 1.1563-1(a)(3) to require that the same five or fewer persons "'own . . . singly or in combination'" the prescribed percentages of voting power or total value.<sup>92</sup> Thus, the deference issue was whether the Treasury's regulatory interpretation—that the prescribed percentages be owned either singly or in combination—was valid.<sup>93</sup>

The taxpayer argued that part A included a "common-ownership requirement" because of Congress' intent in section 1563 to "identify[ ] interrelated corporations that are . . . subdivided portions of a larger entity."<sup>94</sup> Contrarily, the Commissioner argued that under its regulation the 50% requirement sufficiently measured the interrelationship between two corporations.<sup>95</sup> Accordingly, per the Commissioner, the 80% requirement was independently significant.<sup>96</sup> It insured that the corporate group members were closely held, so that, when necessary, the majority shareholders could obtain additional control without "'dealing with a large number of other shareholders.'"<sup>97</sup>

The Supreme Court accepted the taxpayer's argument that Congress intended a "common-ownership" requirement for part A of the "brother-sister" definition.<sup>98</sup> In reviewing both the statute and its legislative history, the Court used traditional legislative construction techniques. First, the Court noted that the language of the statute "harmonized" more with the taxpayer's view than

91. *Id.* at 18 n.2 (quoting 26 U.S.C. § 1563(a)(2) (1994)).

92. *Id.* at 18-19 (quoting Treas. Reg. § 1.1563-1(a)(3), 26 C.F.R. § 1.1563-1(a)(3) (1981)). Pursuant to § 1561(a), a "controlled group of corporations", as determined by who owns and controls shares in the corporations, was limited to one corporate surtax exemption. *Id.* at 18. Thus, if the ownership of both the taxpayer and Vogel Popcorn were such that they were members of a controlled group, the combined corporations would be entitled to just one such exemption. However, in order to be entitled to this benefit, the corporations, according to § 1563(a)(2), had to be a "brother-sister controlled group" of corporations. *Id.*

93. *Id.* at 19. Because the taxpayer's majority shareholder satisfied part B of the 1563(a)(2) test by owning more than 50 percent of both corporations, the real issue was whether his ownership satisfied part A (the 80% requirement). *Id.* at 21-22.

94. *Id.* at 22.

95. *Id.* at 23.

96. *Id.*

97. *Id.*

98. *Id.* at 25.

with the Treasury's regulation.<sup>99</sup> Indeed, according to the Court, the term "brother-sister controlled group," connotes a "close horizontal relationship between two" corporations that is reflected more in a common-ownership arrangement.<sup>100</sup> Second, the structure of the statute—first defining the controlling group of shareholders as five or fewer and then setting forth the ownership requirements—suggests common-ownership.<sup>101</sup> Finally, there was no language in part A of the statute requiring that the 80% ownership be "singly or in combination" as indicated in the regulation.<sup>102</sup>

Even assuming that the statute was somehow ambiguous, the Court concluded that a review of the legislative history quickly cleared up any ambiguity.<sup>103</sup> According to the committee reports,<sup>104</sup> the purpose of the controlled-group test was to target interrelated corporations by curbing abusive multiple incorporations through which large corporations subdivide into smaller ones to receive special tax benefits.<sup>105</sup> Accordingly, a 1964 definition of "brother-sister controlled group" clearly included a common-ownership requirement because the same person had to own 80% of all corporations in the group.<sup>106</sup> Even more telling in the legislative history were the Treasury's 1969 tax reform proposals in which the Treasury stressed that the same five or fewer persons owning at least 80% of the voting stock of each corporation must also satisfy the 50% requirement.<sup>107</sup> The Court found this history to be clearly

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 26.

103. *Id.*

104. *Id.* at 27. The Court then cited the House Ways and Means Committee Report, which provides:

Large organizations have been able to obtain substantial benefits . . . by dividing the organization's income among a number of related corporations. Your committee does not believe that large organizations which operate through multiple corporations should be allowed to receive the substantial and unintended tax benefits resulting from the multiple use of the surtax exemption and the other provisions of present law.

*Id.* (quoting H.R. Rep. No. 413, 91st Cong., 1st Sess., pt. 1, at 98, *reprinted in* 1969 U.S.C.C.A.N. 1746-1747).

105. *Vogel*, 455 U.S. at 26-27.

106. *Id.* at 28.

107. *Id.* at 29.

incompatible with the Treasury's singly or in combination regulatory interpretation.<sup>108</sup>

The Court's invalidation of the regulation in *Vogel* does not run counter to what one would have expected under pre-*Chevron* analysis. Indeed, the deference issue in *Vogel* concerned interpretation of a term that Congress, while not addressed in the language of the statute, clearly contemplated when they drafted it. In fact, the Treasury, as an institution, fought for, and advanced the interpretation that was antithetical to the one espoused in its regulation.<sup>109</sup> In the presence of such overwhelming evidence of congressional intention, the Court had very little choice other than to invalidate the Treasury's rule.

Another pre-*Chevron* case in which the Supreme Court did not defer to the Treasury's regulatory interpretation of a statutory term is *Rowan Cos., Inc., v. United States*.<sup>110</sup> *Rowan*<sup>111</sup> involved the Treasury's regulatory interpretation of the term "wages" for purposes of the Federal Insurance Contributions Act (FICA)<sup>112</sup> and the Federal Unemployment Taxation Act (FUTA).<sup>113</sup> The deference issue was whether the Treasury's differing regulatory interpretations of the term "wages" for FICA/FUTA purposes and for federal income tax purposes were valid.<sup>114</sup>

108. *Id.* at 30.

109. *Id.*

110. 452 U.S. 247 (1981).

111. In *Rowan*, the taxpayer-employer owned and operated oil and gas drilling rigs. *Id.* at 248. Because the rigs were often located several miles from land, it cost the taxpayer significantly less money to provide its employees with meals and lodging near the rig each day of work than to transport the employees back and forth between the rig and land each day. *Id.* The taxpayer did not include the value of the meals and lodging in its computation of employee wages for purposes of paying FICA and FUTA taxes, nor for the purpose of withholding federal income taxes. *Id.*

112. *Id.* (citing 26 U.S.C. §§ 3101-3127 (1989)). FICA imposes on the employer an "excise tax, with respect to having individuals in his employ, equal to [specified] percentages of the wages . . . paid by him with respect to employment." *Id.* at n.2 (quoting 26 U.S.C. § 3111 (1970)). The purpose of FICA taxes is to fund social security.

113. *Rowan*, 452 U.S. at 248 (citing 26 U.S.C. §§ 3301-3127 (1989)). FUTA imposes upon the employer an "excise tax, with respect to having individuals in [their] employ, equal to [specified percentages] of the total wages . . . paid by [them] during the calendar year with respect to employment." *Id.* at n.2 (quoting 26 U.S.C. § 3301 (1970)). The purpose of FUTA taxes is to fund unemployment.

114. *Rowan*, 452 U.S. at 250. Specifically, the issue was whether "wages" included the value of meals and lodging provided by an employer, for the employer's convenience, to its employees. *Id.* at 248.

By statute, Congress defined "wages" for FICA and FUTA purposes as including "all remuneration for employment, including the cash value of all remuneration . . . paid in any medium other than cash."<sup>115</sup> For federal income tax withholding purposes, "wages" means "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration . . . paid in any medium other than cash."<sup>116</sup> Pursuant to its regulations, the Treasury interpreted the FICA and FUTA "wages" definition to include the meals and lodging provided by the taxpayer-employer to its employees.<sup>117</sup> Conversely, the Treasury interpreted the federal income tax withholding definition of "wages"<sup>118</sup> as not including the employer-provided meals and lodging.<sup>119</sup>

The Supreme Court held that the inconsistent regulatory interpretations of "wages" contradicted both the historical language of the statutes and their legislative histories.<sup>120</sup> Indeed, since original enactment of the FICA and FUTA taxes and the federal withholding tax, Congress had used nearly identical definitions of the term "wages" as the base for each

115. 26 U.S.C. § 3121(a) (1994) (FICA); *id.* § 3306(b) (FUTA).

116. *Rowan*, 452 U.S. at 249 n.4 (quoting 26 U.S.C. § 3401(a)).

117. *Rowan*, 452 U.S. at 250-51. Pursuant to § 31.3121(a)-1(f)(FICA) and § 31.3306(b)-1(f) (FUTA):

[F]acilities or privileges . . . furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term 'facilities or privileges,' however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

*Id.* at 252 (quoting Treas. Reg. § 31.3121(a)-1(f), 26 C.F.R. § 31.312(a)-1(f) (1980); Treas. Reg. § 31.3306(b)-1(f), 26 C.F.R. § 31.3306(b)-1(f) (1980)).

118. *Id.* at 251. Pursuant to 26 C.F.R. § 31.3401(a)-1(b)(9), the employer excludes the value of meals and lodging from "wages" to the extent the employee excludes the value from gross income. *Id.*

119. *Id.* at 250-51. After paying the additional assessment associated with inclusion of the value of the meals and lodging as "wages", the taxpayer sued for a refund in federal district court. *Id.* at 250. The district court granted summary judgment to the Service. *Id.* The Fifth Circuit Court of Appeals affirmed, justifying its decision by focusing on the purposes of FICA and FUTA as contrasted to the purpose of federal income tax withholding. *Id.*

120. *Rowan*, 452 U.S. at 255.

tax.<sup>121</sup> Additionally, legislative history indicated that Congress was concerned with “the interest of simplicity and ease of administration” when enacting the federal withholding tax.<sup>122</sup> Thus, Congress’ decision to define “wages” for withholding tax purposes consistent with the then-existing definition of “wages” for FICA and FUTA purposes was consistent with the legislative history.<sup>123</sup> Accordingly, the Court invalidated the Treasury’s regulatory attempt to create different definitions for FICA, FUTA and federal withholding purposes.<sup>124</sup>

### C. *The Chevron Decision*

The most complete analysis of the Supreme Court’s modern principle of deference to an agency’s regulatory interpretation of a statute is contained in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*<sup>125</sup> The ultimate issue in *Chevron* was whether an agency, the Environmental Protection Agency (EPA), or a federal court should have the final say as to the meaning of a term in a federal statute when Congress has failed to define the term.<sup>126</sup> After criticizing the lower court for refusing to accept EPA’s determination as to what the statutory term “stationary source” meant, the Supreme Court concluded that the agency’s view of the term must be respected.<sup>127</sup>

#### 1. *The Rule Challenge Proceeding*

The *Chevron* case resulted from judicial review of an EPA rule-challenge proceeding as authorized by 42 U.S.C. § 7607(b)(1).<sup>128</sup> Section 7607(b)(1) permits a person to seek judicial review of pollution-related regulations promulgated by EPA. The petition for review must be filed in a timely fashion—usually within sixty days of publication.<sup>129</sup> Providing for judicial review of an

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121. *Id.*

122. *Id.*

123. *Id.* at 257.

124. *Id.* at 263.

125. 467 U.S. 837 (1984).

126. *Id.* at 839-42.

127. *Id.* at 866.

128. *Id.* at 841.

129. 42 U.S.C. § 7607(b)(1) provides, in part:

(b) Judicial review.

(1) A petition for review of action of the Administrator in promulgating any national primary or secondary ambient air

agency's rules and regulations is typical in administrative law parlance—both at the federal<sup>130</sup> and state level.<sup>131</sup>

## 2. *The Federal Statute Interpreted by EPA*

The Federal law at issue in *Chevron*, 42 U.S.C. § 7502(b)(6), concerned standards for eliminating air pollution.<sup>132</sup> Specifically, Congress imposed a permit requirement for “‘new or modified major stationary sources’” of air pollution located in states that had not achieved previous air quality standards established by the EPA.<sup>133</sup> Thus, before one could construct or operate a new or modified stationary source in a “nonattainment state,” Congress required that a permit be issued by the state under an EPA-approved permit program.

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quality standard, any emission standard or requirement under section 7412 of this title, any standard of performance or requirement under section 7411 of this title, any standard under section 7521 of this title (other than a standard required to be prescribed under section 7521(b)(1) of this title, any determination under section 7521(b)(5) of this title, any control or prohibition under section 7545 of this title, any standard under section 7571 of this title any rule issued under section 7413, 7419, or under section 7420 of this title, or any other nationally applicable regulations promulgated, or final action taken, by the Administrator under this chapter may be filed only in the United States Court of Appeals for the District of Columbia. . . . Any petition for review under this subsection shall be filed within sixty days from the date notice of such promulgation, approval, or action appears in the Federal Register, except that if such petition is based solely on grounds arising after such sixtieth day, then any petition for review under this subsection shall be filed within sixty days after such grounds arise.

42 U.S.C. § 7607(b)(1) (1994).

130. *See, e.g.*, 5 U.S.C. § 702 (1996) (“A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof.”).

131. *See, e.g.*, FLA. STAT. ANN. § 120.68 (1995) (“A party who is adversely affected by final agency action is entitled to judicial review.”).

132. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 839-40 (1984). The court cited § 7502(b)(6), which then provided: “[t]he plan provisions required by subsection (a) shall . . . require permits for the construction and operation of new or modified major stationary sources in accordance with section 173 (relating to permit requirements).” *Id.* at 840 n.1 (quoting 42 U.S.C. § 7502(b)(6)).

133. *Id.* at 840.

### 3. *The Challenged EPA Regulations*

The EPA regulations challenged in *Chevron* interpreted the term “stationary source” as used in the permit program statute, 42 U.S.C. § 7502(b)(6). The regulations provided that:

(i) ‘Stationary source’ means any building, structure, facility, or installation which emits or may emit any air pollutant subject to regulation under the Act. (ii) ‘Building, structure, facility, or installation’ means all the pollution-emitting activities which belong to the same industrial grouping, are located on one or more contiguous or adjacent properties, and are under the control of the same person (or persons under common control) except the activities of any vessel.<sup>134</sup>

The EPA issued this interpretive regulation pursuant to its congressionally granted general rule-making authority.<sup>135</sup>

Pursuant to the EPA’s regulation, pollutants could be measured as emitted from a controlled group of polluters located in the same general area.<sup>136</sup> In essence, one industrial grouping of polluters—regardless of the number of separate smoke stacks operated by the group—was treated as one single plant for EPA regulatory purposes. The EPA regulation permitted what has been called a plant-wide definition of the term “stationary source”—allowing the entire plant to be treated as contained within a single bubble.<sup>137</sup> Accordingly, increased emissions from a new or modified emitting device could be netted against reduced emissions from another device located within the same commonly controlled grouping of devices.<sup>138</sup>

### 4. *The Court of Appeals’ Decision*

After appropriate review, the Court of Appeals for the District of Columbia Circuit set aside the EPA regulations as contrary to law.<sup>139</sup> The Circuit Court observed that the relevant portions of

134. *Id.* at 840 n.2 (quoting 40 C.F.R. § 51.18(j)(1)(i)-(ii) (1983)).

135. *See* 42 U.S.C. § 7601(a)(1) (1994); Coverdale, *supra* note 5, at 49-50. *But see* April, *supra* note 45, at 63 (referring to the *Chevron* regulation as legislative). For purposes of this Article, the labeling of the *Chevron* regulation as legislative or interpretive has no practical effect. Indeed, even as interpretive, the *Chevron* regulation went through notice and comment. *See* 46 Fed. Reg. 50766-71 (1981).

136. *Chevron*, 467 U.S. at 840.

137. *Id.*

138. *Id.*

139. *Id.* at 841.



the implemented federal statute do not define what Congress meant by the term "stationary source" with regard to the permit program.<sup>140</sup> Further, that court noted that Congress failed to address this precise issue in the legislative history.<sup>141</sup> Thus, faced with no guidance from Congress, the Circuit Court reasoned that the court-determined purposes of the permit program should direct it to the right conclusion.<sup>142</sup>

The District of Columbia Circuit Court determined that permitting bubbling in nonattainment states could maintain air quality but would not improve it.<sup>143</sup> Therefore, the court-determined purpose of the permit program was to improve air quality. The court invalidated the EPA regulation allowing bubbling as inconsistent with this unstated Congressional mandate.<sup>144</sup>

### 5. *The Supreme Court's Decision*

The Supreme Court reversed the District of Columbia Circuit because it failed to respect the EPA's status as the agency charged with implementing and administering environmental laws.<sup>145</sup> The high court noted that the Circuit Court erred when it chose to adopt a static, unyielding definition of the term "stationary source" after it decided that Congress failed to define the term.<sup>146</sup> Instead, the circuit court should have deferred to the EPA's expertise in environmental matters and upheld the more flexible definition of "stationary source" contained in the challenged regulation.

#### a. *The Chevron Two-Step*

The standard applied by the Supreme Court when reversing the Circuit Court has been affectionately referred to as the *Chevron* "two-step."<sup>147</sup> Step one requires that a court reviewing

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.* at 841-42.

144. *Id.* at 842.

145. *Id.*

146. *Id.*

147. See, e.g., Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 YALE J. ON REG. 283, 287-88 (1986) referring to the following language from *Chevron*:

When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the

an agency's regulatory interpretation of a statute administered by the agency ask whether Congress has spoken to the precise question at issue.<sup>148</sup> If Congress has already addressed the issue, then both the court and the agency must yield to Congressional intent.<sup>149</sup> If Congress has failed to clearly address the issue—either in the statute or in the legislative history—the court must then move to step two and ask whether the agency's interpretation is “permissible” under the statute.<sup>150</sup> If it is, the agency's rule should be upheld; if not, the reviewing court must invalidate the agency's rule.<sup>151</sup>

*b. The Two-Step Rationale*

The Supreme Court's rationale for this two-step approach emanates from the role of agencies as statutory gap-fillers.<sup>152</sup> When an agency is empowered by Congress to administer a congressional program, the agency necessarily has the power to formulate policy and issue rules to fill any statutory gaps left by Congress.<sup>153</sup> Thus, when Congress states that an agency shall promulgate rules to implement a particular statute, the agency is said to have an explicit delegation from Congress to issue regulatory guidance.<sup>154</sup> Accordingly, such legislative regulations should be upheld unless arbitrary or capricious.<sup>155</sup> Additionally, when Congress states that an agency is charged with enforcing a

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question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

*Chevron*, 467 U.S. at 842-43.

148. *Id.* at 842.

149. *Id.* at 842-43.

150. *Id.* at 843. Permissibility necessarily entails notions of delegated authority. Hence, permissibility under *Chevron* is premised on the agency interpretation being within the agency's area of expertise and in a binding format. *See supra* notes 21-48 and accompanying text.

151. *Chevron*, 467 U.S. at 843-44.

152. *See id.*

153. *Id.* at 843.

154. *Id.* at 843-44.

155. *Id.*

group of statutes, the agency has an implicit congressional delegation to issue all necessary interpretive rules.<sup>156</sup> Notably, if the agency doing the interpretation does not have "administrative" authority with respect to the interpreted statute, *Chevron* deference is not required.<sup>157</sup>

Professor John Coverdale argued that this gap-filler rationale supports a finding that *Chevron* deference applies to Treasury legislative regulations, but does not support a finding that it applies to Treasury interpretive regulations.<sup>158</sup> His argument is based on the historical notion that legislative and interpretive regulations are distinguishable such that legislative regulations deserve more "weight" than interpretive regulations.<sup>159</sup> The argument is as follows:

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156. *Chevron* suggests that either silence or ambiguity is sufficient ground upon which to base a claim of implicit delegation to an agency, assuming of course that the agency has broad policy-making authority in the substantive area:

Congress intended to accommodate both interests, but did not do so itself on the level of specificity presented by [this case]. Perhaps that body consciously desired the Administrator to strike the balance at this level, thinking that those with great expertise and charged with responsibility for administering the provision would be in a better position to do so; perhaps it simply did not consider the question at this level; and perhaps Congress was unable to forge a coalition on either side of the question, and those on each side decided to take their chances with the scheme devised by the agency. For judicial purposes, it matters not which of these things occurred.

*Chevron*, 467 U.S. at 865.

157. See *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649 (1990).

158. Coverdale, *supra* note 5, at 67-70.

159. *Id.* The article states the following:

Both courts and commentators have long held that general authority regulations are merely interpretive and that, therefore, courts should review them more searchingly than legislative regulations issued under a grant of specific authority. As early as 1940, Stanley S. Surrey, the most influential tax theorist of his generation, noted that the general delegation of authority to the Treasury is not sufficient to delegate legislative authority. Twenty-five years later, the then Chief Counsel of the Internal Revenue Service, Mitchell Rogovin, highlighted the distinction between legislative regulations promulgated under a specific grant of authority and interpretive regulations promulgated under the more general grant of authority to the secretary. This distinction was embraced by the Supreme Court in *Rowan* and *Vogel Fertilizer*. It has since become an obligatory reference in court opinions reviewing Treasury regulations. Such opinions regularly treat the step of determining whether a regulation was issued under section 7805(a), the general grant of authority or under a specific grant of authority as an indispensable "preliminary task."

*Id.* at 68-69 (citations omitted).

When Congress grants . . . [legislative] regulatory authority, it should be understood to be saying that the statute is incomplete and that it intends the Commissioner to elaborate a policy. Conversely, when Congress does not grant . . . [legislative] authority, it should be understood to view the statute as complete, requiring only interpretation and application, subject to court review. To construe congressional silence or mere ambiguity of the tax statutes as equivalent to a . . . [legislative] delegation of regulatory authority ignores the established background norm against which Congress has enacted tax legislation, renders meaningless the specific delegations Congress has enacted in the Internal Revenue Code, and thereby flies in the face of the maxim that courts should strive to give effect to every provision in a statute.<sup>160</sup>

This Article disagrees with Professor Coverdale's argument for two reasons. First, the facts of *Chevron* indicate that its two-step analysis applies to all agency regulations. Nowhere in the opinion does the Court, in light of its obvious knowledge of the history of differentiating legislative and interpretive regulations, indicate that *Chevron*'s applicability is somehow limited to one of the two types of regulations. Indeed, if *Chevron* were so limited, it would probably be limited to interpretive, not legislative, regulations since *Chevron* involved an EPA interpretive regulation.<sup>161</sup> With respect to this latter point, Professor Coverdale points out that "courts reviewing environmental regulations [unlike with tax regulations] rarely stress the distinction between [legislative and interpretive regulations]."<sup>162</sup> However, because we have only one Congress—not an environmental Congress and a separate tax Congress—the significance of this distinction is unclear.<sup>163</sup>

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160. *Id.* at 69-70.

161. See Coverdale, *supra* note 5, at 49-50.

162. *Id.* at 70.

163. This is not to say that Professor Coverdale's view is a result of "tax myopia." See, e.g., Caron, *Mamas Don't Let*, *supra* note 44, at 518 (arguing "that tax law too often is mistakenly viewed by lawyers, judges, and law professors as a self-contained body of law"). Instead, the significance of the distinction between tax regulations and environmental regulations may lie in the fact all tax regulations—legislative and interpretive—are subjected to the same stringent formalities. Thus, because all tax regulations are subject to public comment and are published in the Federal Register, they are intended to be binding on both the Treasury and the courts. See *supra* notes 21-48 and accompanying text. But this analysis should lead one to conclude that the distinction between environmental and tax regulations indicates that all tax regulations—legislative and interpretative—should be subject to the same deference

Second, on a more fundamental level, congressional silence or ambiguity is subject to more interpretations than the one concluding that Congress has not delegated authority to the agency to act. For instance, congressional silence may mean that Congress, as a legislative body, simply did not contemplate the precise issue being considered. Silence may also mean that Congress considered the issue, but members of Congress could not agree collectively on how to address the issue by statute. Overall, given that legislators are not generally experts in all fields of legislation, it is conceivable that legislative regulations are intended to give specific guidance where Congress has considered the matter and agreed that such guidance is warranted. Conversely, interpretive regulations, under such a paradigm, would serve as a catch-all—allowing agency experts to fill legislative gaps that Congress failed to either anticipate or address statutorily.

*c. Significance of Court's Role in the Two-Step*

Even though the *Chevron* decision seemingly grants extraordinary interpretive powers to executive agencies, the court's role in judicial review of agency rules and regulations is far from insignificant. Indeed, step one of the *Chevron* two-step analysis recognizes that the court, not the agency, determines if Congress has directly addressed "the precise question at issue."<sup>164</sup> Thus, the court, as the final authority on statutory construction issues, must reject regulatory constructions that are contrary to the clearly expressed intent of Congress. For instance, if the Court in *Chevron* had determined initially that Congress rejected the idea of a bubble concept for nonattainment areas, the EPA's regulation adopting such a concept would have been rejected hands down. Even if the Court and the agency disagreed regarding Congress' intent on the issue, the agency's evaluation of intent would have to give way to the Court's independent determination.

Note, however, that the Court's independent determination at step one does not, as has been suggested by other commentators, *mandate* that the court ignore the agency's properly

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standards.

164. See *Chevron*, 467 U.S. at 842. Further, the court states that "[t]he judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." *Id.* at 843 n.9.

promulgated rule.<sup>165</sup> Professor Coverdale recently argued for a return to pre-*Chevron* traditional deference standards when courts review legislative regulations, primarily because “[i]t is not appropriate for the court to ignore the agency’s views altogether in its initial reading of the statute.”<sup>166</sup> However, the language of step one contains no requirement that the reviewing court ignore the agency’s views.<sup>167</sup> Instead, step one only speaks to who—the court or the agency—should decide what Congress meant by its statutory language.<sup>168</sup> Placing any limitation on the judiciary that denies courts the right to consider any and all available information, including the agency’s views, is contrary to *Chevron*’s call for “traditional” methods of statutory construction at step one.<sup>169</sup> Thus, even at step one, the court may (not must) rely on the agency’s interpretation to assist the court in determining what the language of a statute means.<sup>170</sup>

Step two of the *Chevron* analysis also leaves some room for judicial fiat, albeit less than in step one. Step two requires that, in the absence of clear congressional intent, an agency’s regulatory interpretation must be upheld if it is a permissible

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165. See, e.g., Coverdale, *supra* note 5, at 54-55; see also Richard J. Pierce, Jr., *Chevron and its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 VAND. L. REV. 301, 301-02 (1988).

166. Coverdale, *supra* note 5, at 55.

167. See *Chevron*, 467 U.S. at 842-43.

168. *Id.*

169. *Id.* at 843 n.9 (“If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect.”); see Peter L. Strauss, *One Hundred Fifty Cases Per Year: Some Implications Of The Supreme Court’s Limited Resources For Judicial Review Of Agency Action*, 87 COLUM. L. REV. 1093, 1125 (1987).

The traditional tools of statutory construction have long included reliance (among other indications of meaning) on agency constructions given the statute in other proceedings—as, for example, in litigation under the Fair Labor Standards Act. Like the testimony of involved executive branch officials at congressional hearings or the initial interpretations given a statute by the responsible agency, an agency interpretation that has remained consistent over the years can plausibly be regarded as evidence of what is assumed to be a determinate congressional meaning, one to be found out by the courts.

Strauss, *supra* at 1125 (footnotes omitted); see also Anthony, *supra* note 14, at 18-19 n.65.

170. See, e.g., *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944); *Lukhard v. Reed*, 481 U.S. 368 (1987); *Norwegian Nitrogen Prods. Co. v. United States*, 288 U.S. 294 (1933).

construction of the statute.<sup>171</sup> In *Chevron*, the Supreme Court upheld the EPA's regulatory choice among competing and conflicting policy goals as reasonable and quite permissible.<sup>172</sup> However, it is conceivable, though highly unlikely, that an agency could issue a regulation that is in no way within the realm of reason. In such an unlikely case, step two of *Chevron* would require that the agency's rule be invalidated.

### III. DEFINING DEFERENCE IN THE POST-CHEVRON ERA

#### A. *Introduction to the Post-Chevron Era*

In the twelve years since *Chevron*, many commentators have written about how the federal courts, including the Supreme Court, have failed to adhere to *Chevron*.<sup>173</sup> However, in so doing, few commentators have clearly defined what *Chevron* deference actually means. By closely scrutinizing the cases decided since *Chevron*, it is apparent that the issue of regulatory deference is rarely ruled upon by the Supreme Court.<sup>174</sup> Recall that *Chevron* involved a rule-challenge proceeding in which the sole issue was whether the agency's "regulatory" interpretation of the term "stationary source" was valid,<sup>175</sup> not whether the agency applied the regulation in a proper manner.<sup>176</sup> Nor did the court avoid the issue of the regulation's validity in *Chevron* by ruling on some non-deference related issue.<sup>177</sup> Instead, the high court in *Chevron* squarely decided the issue of the validity of an agency's regulatory interpretive action.

A review of the reported Supreme Court cases decided after *Chevron* involving Treasury regulations<sup>178</sup> reveals that only a

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171. *Chevron*, 467 U.S. at 843.

172. *Id.* at 842-43.

173. See generally Coverdale, *supra* note 5; Merrill, *supra* note 4. But see generally Starr, *supra* note 147.

174. See, e.g., *United States v. Irvine*, 114 S. Ct. 1473 (1994).

175. See *Chevron*, 467 U.S. at 840-41.

176. See, e.g., *Newark Morning Ledger Co. v. United States*, 507 U.S. 546 (1993).

177. See, e.g., *Irvine*, 114 S. Ct. 1473.

178. See, e.g., *Commissioner v. Schleier*, 115 S. Ct. 2159 (1995); *United States v. Williams*, 115 S. Ct. 1611 (1995); *United States v. Irvine*, 114 S. Ct. 1473 (1994); *Newark Morning Ledger Co. v. United States*, 507 U.S. 546 (1993); *United States v. McDermott*, 507 U.S. 447 (1993); *United States v. Hill*, 506 U.S. 546 (1993); *United States v. Burke*, 504 U.S. 229 (1992); *Barnhill v. Johnson*, 503 U.S. 393 (1992); *Holywell Corp. v. Smith*, 503 U.S. 47 (1992); *Cottage Sav. Ass'n v. Commissioner*, 449 U.S. 554 (1991); *Cheek v. United States*, 498 U.S. 192 (1991); *Davis v. United States*, 495 U.S. 472 (1990); *Colonial American Life Ins. Co. v. Commissioner*, 491 U.S. 244

few resulted in a majority decision by the Court as to the validity of a Treasury regulation.<sup>179</sup> Instead, most of these cases either did not involve an issue of deference to the Treasury's regulatory interpretation of a tax statute;<sup>180</sup> or, if Treasury regulatory deference was an issue, the cases were consistent with *Chevron*.<sup>181</sup> This is contrary to the conclusions reached by other commentators who looked at the effect of *Chevron* generally, not just its effect on tax cases.<sup>182</sup> Additionally, this conclusion is at odds with at least one other commentator who concludes that federal courts have generally failed to abide by *Chevron* when reviewing tax regulations.<sup>183</sup> This part of the Article examines some of these post-*Chevron* cases in an attempt to justify the conclusion that *Chevron* deference is alive and well with respect to Treasury regulations.

#### *B. Cases in Which the Court Decided the Issue of Deference to the Treasury's Regulation at Chevron's Step One*

In the most recent post-*Chevron* case, *Commissioner of Internal Revenue v. Schleier*,<sup>184</sup> the Supreme Court did not address the validity of the Treasury's regulation regarding the exclusion of damage recoveries from gross income. Instead, the Court decided the substantive issue in the case at *Chevron*'s step one (for example, based on the plain meaning of the statute).<sup>185</sup> The

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(1989); *Mead Corp. v. Tilley*, 490 U.S. 714 (1989); *K-mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988); *K-Mart Corp. v. Cartier, Inc.*, 485 U.S. 176 (1988); *Arkansas Best Corp. v. Commissioner*, 485 U.S. 212 (1988); *United States v. General Dynamics Corp.*, 481 U.S. 239 (1987); *R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, 479 U.S. 130 (1986); *United States v. Hughes Properties, Inc.*, 476 U.S. 593 (1986); *United States v. American College of Physicians*, 475 U.S. 834 (1986); *United States v. National Bank of Commerce*, 472 U.S. 713 (1985); *United States v. Boyle*, 469 U.S. 241 (1985); *Paulsen v. Commissioner*, 469 U.S. 131 (1985); *Regan v. Wald*, 468 U.S. 222 (1984).

179. See *United States v. Irvine*, 511 U.S. 242 (1994); *Cheek v. United States*, 498 U.S. 192 (1991); *K-mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988); *K-Mart Corp. v. Cartier, Inc.*, 485 U.S. 176 (1988).

180. See, e.g., *K-mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988); *K-Mart Corp. v. Cartier, Inc.*, 485 U.S. 176 (1988).

181. See, e.g., *Irvine*, 511 U.S. 242 (1994).

182. See, e.g., *Merrill*, *supra* note 4 (concluding that *Chevron* framework was used in only one-half of cases in which the court considered the deference issue).

183. See, e.g., *Coverdale*, *supra* note 5, at 57-62.

184. 115 S. Ct. 2159 (1995).

185. *Id.* at 2167. In *Schleier* the taxpayer recovered back-pay and liquidated damages pursuant to settlement of claims made under the Age Discrimination in Employment Act of 1967 (ADEA). *Id.* at 2161-62. The Service issued an income tax



deference issue in *Schleier* was whether the Treasury's regulatory interpretation of section 104(a)(2) required that the damages be excluded from the taxpayer's gross income.<sup>186</sup> At the time, Treasury Regulation section 1.104-1 provided:

Section 104(a)(2) [of the Internal Revenue Code] excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness. The term 'damages received (whether by suit or agreement)' means an amount received (other than workman's compensation) through prosecution of a legal suit or action based upon *tort* or *tort type rights*, or through a settlement agreement entered into in lieu of such prosecution.<sup>187</sup>

The taxpayer claimed that the plain language of this regulation required that the damages be excluded from gross income because ADEA damages are recovered for violation of "tort or tort type rights."<sup>188</sup>

Without accepting, or rejecting, the taxpayer's contention that ADEA damages were described by section 1.104-1(c), the Court rejected the taxpayer's claim of exclusion based on the plain language of section 104(a).<sup>189</sup> Indeed, the regulation and the statute require that an amount excluded from gross income by

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deficiency notice to the taxpayer based on the taxpayer's failure to pay income tax on the liquidated damages portion of the ADEA settlement. *Id.* at 2162. Additionally, the taxpayer filed a petition for refund of income taxes paid on the back-pay damages portion of that same settlement. The United States Tax Court determined that both the back-pay and liquidated damages amounts were excludable from the taxpayer's gross income by § 104(a)(2) as "damages received . . . on account of personal injuries or sickness." *Id.* On appeal, the Fifth Circuit affirmed. *Id.* at 2162-63. On writ of certiorari, the Supreme Court sided with the Treasury and reversed the Fifth Circuit, concluding that the ADEA damages were not received "on account of personal injuries" as required by § 104(a)(2). *Id.* at 2165, 2167.

186. *Id.* at 2165-66. Section 104(a)(2) provided:

Compensation for injuries or sickness (a) In general.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include . . . (2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness.

*Id.* at 2163 n.3 (quoting 26 U.S.C. § 104(a)).

187. *Schleir*, 115 S. Ct. at 2165 (quoting Treas. Reg. § 1.104-1(c), 26 C.F.R. § 1.104-1(c) (1994)) (emphasis added).

188. *Id.* at 2165-66.

189. *Id.* at 2166-67.

section 104(a)(2) be received both in a "tort or tort type action" and "on account of personal injuries or sickness."<sup>190</sup> Writing for the majority, Justice Stevens stated: "[t]he regulatory requirement [for exclusion from gross income] that the amount be received in a tort-type action is not a substitute for the statutory requirement that the amount be received 'on account of personal injuries or sickness'; it is an additional requirement."<sup>191</sup> Thus, even accepting the taxpayer's claim that the ADEA damages were covered by the regulation, those damages were not excluded from gross income because they were not completely covered by the statute.<sup>192</sup> That is, the ADEA damages were not "received on account of personal injuries or sickness."<sup>193</sup>

Notice that the Court's holding in *Schleier* is consistent with *Chevron*'s two-step approach to deference questions. Under *Chevron*, the court must first establish what Congress meant when it enacted the statute in order to determine whether Congress addressed the precise issue. In *Schleier*, the Court did just that when it established that the plain meaning of the statutory exclusion is that the amount excluded must be received "on account of personal injuries."<sup>194</sup> Thus, without regard to whether an amount is or is not section 104(a)(2) "damages," the amount is not excludable if received on account of a person's age or on account of a person being fired.<sup>195</sup> According to the Court, neither attaining a particular age nor being fired is a personal injury or sickness.<sup>196</sup>

Notice also that the Court in *Schleier* referred to the Treasury's "differing interpretations" of Treasury Regulation section 1.104-1(c) as a basis for not according the Treasury's position in the case any special deference.<sup>197</sup> One might argue that this is an indication of the lack of deference the Court has for the Treasury's regulatory interpretations. However, the

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190. *Id.* at 2166.

191. *Id.*

192. *Id.*

193. *Id.* at 2165; see also *United States v. Burke*, 504 U.S. 229 (1992).

194. *Schleier*, 115 S. Ct. at 2163-64.

195. *Id.* at 2164.

196. *Id.*

197. *Id.* at 2166 n.7 ("In view of the commissioner's differing interpretations of her own regulation, we do not accord her present litigating position any special deference. We do agree, however, that she reads the regulation correctly in this case."). But see *Udall v. Tallman*, 380 U.S. 1, 16 (1965) (agency's reasonable interpretation of its own regulations is entitled to deference).

Court did not take issue with the Treasury's regulatory interpretation of a statute. Instead, the Court merely raised a concern about the Treasury interpreting that regulation differently in different cases.<sup>198</sup> Thus, the degree of judicial deference to the Treasury's regulatory interpretations of statutes, as opposed to its non-regulatory interpretations of its own regulations, is unscathed.<sup>199</sup>

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198. *Schleier*, 115 S. Ct. at 2166 n.7.

199. Section 104(a)(2) was substantially changed after *Schleier* by Section 1605 of the Small Business Job Protection Act of 1996, which provides:

1605. REPEAL OF EXCLUSION FOR PUNITIVE DAMAGES AND FOR DAMAGES NOT ATTRIBUTABLE TO PHYSICAL INJURIES OR SICKNESS.

(a) IN GENERAL.—Paragraph (2) of section 104(a) (relating to compensation for injuries or sickness) is amended to read as follows:

“(2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness”;

(b) EMOTIONAL DISTRESS AS SUCH TREATED AS NOT PHYSICAL INJURY OR PHYSICAL SICKNESS.—Section 104(a) is amended by striking the last sentence and inserting the following new sentence: “For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness. The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress.”

(c) APPLICATION OF PRIOR LAW FOR STATES IN WHICH ONLY PUNITIVE DAMAGES MAY BE AWARDED IN WRONGFUL DEATH ACTIONS.—Section 104 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

“(c) APPLICATION OF PRIOR LAW IN CERTAIN CASES.—The phrase ‘(other than punitive damages)’ shall not apply to punitive damages awarded in a civil action—

(1) which is a wrongful death action, and

(2) with respect to which applicable State law (as in effect on September 13, 1995 and without regard to any modification after such date) provides, or has been construed to provide by a court of competent jurisdiction pursuant to a decision issued on or before September 13, 1995, that only punitive damages may be awarded in such an action.

This subsection shall cease to apply to any civil action filed on or after the first date on which the applicable State law ceases to provide (or is no longer construed to provide) the treatment described in paragraph (2).”

(d) EFFECTIVE DATE.—

The major issue in *United States v. Williams*<sup>200</sup> was whether a person who, under protest, paid tax for another person to remove a tax lien from her property was a “taxpayer” entitled to sue for refund under § 6511(a) of Title 26.<sup>201</sup> As in *Schleier*, the Court made its ruling based on the plain meaning of the statute, § 7701 of Title 26, which defines “taxpayer,” concluding that the payer was a taxpayer.<sup>202</sup> Accordingly, she was entitled to exhaust administrative remedies and file a refund action pursuant to section 1346(a).<sup>203</sup> The Court refused to defer to the Treasury’s litigation position in *Williams* and, instead, held that the payer was a section 6511(a) “taxpayer” even though she was not assessed a tax.<sup>204</sup>

One might argue that *Williams* is a case in which the *Chevron* logic fails because the court refused to defer to the Treasury’s interpretation of the statutory term “taxpayer.” However, this argument is erroneous for two reasons. First, because the Court in *Williams* decided that case based on the plain meaning of section 1346(a) (that is, that Congress addressed the precise issue in the statute), the *Williams* decision is consistent with step one of *Chevron*. Second, and more importantly, this Article’s thesis is that *Chevron* deference only applies when the agency’s interpretation is made by way of a regulation.<sup>205</sup> Therefore, a Treasury attorney’s in-court (non-regulatory) interpretation of a statute does not have the same force and effect as a regulatory interpretation that speaks to the precise issue.

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(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts received after the date of the enactment of this Act, in taxable years ending after such date.

(2) EXCEPTION.—The amendments made by this section shall not apply to any amount received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

Pub. L. No. 104-188, 110 Stat. 1755 (1996).

200. *United States v. Williams*, 115 S. Ct. 1611 (1995).

201. *Id.* at 1615-17.

202. *Id.* at 1617.

203. *Id.* at 1618-19.

204. *Id.*

205. Although the Treasury did have a regulation that defined the term “taxpayer” for purposes of § 6511(a), that definition was merely a statute-tracking definition. That is, the Treasury’s regulation, 26 C.F.R. § 301.7701-16 (1994), merely repeated (in substance) the statute’s definition of “taxpayer” contained in § 7701.

*C. Cases Involving Application of, Not Deference To, the Treasury's Regulation*

*United States v. Irvine*<sup>206</sup> and *Newark Morning Ledger Co. v. United States*,<sup>207</sup> involved the application of, not deference to, Treasury regulations. In *Irvine*, the issue was whether a disclaimer was valid to prevent a taxpayer from being subject to gift tax liability.<sup>208</sup> Under the applicable state law, the disclaimer was effective because it was made within six months of the event identifying the disclaimant and causing her interest to become fixed.<sup>209</sup> Accordingly, the taxpayer treated the disclaimer as effective for federal gift tax purposes and did not pay gift tax associated with the disclaimed amounts.<sup>210</sup> The Service, pursuant to an audit, determined that the taxpayer indirectly transferred the disclaimed property by gift to her children.<sup>211</sup> Therefore, pursuant to the gift tax statute,<sup>212</sup> the taxpayer owed gift tax on the transfer.<sup>213</sup> Further, according to the Service's reading of the Treasury's disclaimer regulation,<sup>214</sup> the taxpayer's attempt to disclaim was not

206. 114 S. Ct. 1473 (1994).

207. 507 U.S. 546 (1993).

208. *Irvine*, 114 S. Ct. at 1475. In *Irvine*, the taxpayer's grandparents created an irrevocable trust in 1917, naming the taxpayer as one of the persons to receive the corpus of the trust upon termination. The taxpayer became aware of her interest in the trust in 1931—when she reached age 21. In 1979, nearly two months after termination of the trust but prior to distribution of the remainder interest, the taxpayer disclaimed her interest in the trust, as a result of which her share of the corpus passed to her children. *Id.*

209. See *id.* (citing MINN. STAT. § 501.211, subd. 3 (1978), repealed by 1989 Minn. Laws, ch. 340, art. 1, § 77 and replaced by MINN. STAT. § 501B.86, subd. 3 (1992) (changing the time permitted for disclaiming to nine months, effective January 1, 1990).

210. *Id.* at 1475.

211. *Id.*

212. The gift tax is imposed by § 2501(a)(1), which reads in part: "[a] tax . . . is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident." 26 U.S.C. § 2501(a)(1) (1994). Pursuant to § 2511(a), the gift tax applies to direct as well as indirect transfers of property by gift: "[s]ubject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." *Id.* § 2511(a).

213. *Irvine*, 114 S. Ct. at 1475-76.

214. In 1959, Treasury regulation § 25.2511-1(c) provided that:

The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed,

effective to avoid gift tax liability.<sup>215</sup> The regulation required that a disclaimer be made within a reasonable time after a taxpayer learns of the creation of the interest, which the *Irvine* taxpayer failed to do.<sup>216</sup>

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constitute gifts subject to tax. See further § 25.2512-8. Where law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right to completely and unqualifiedly refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution of intestate property), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal [sic] and effective under the local law. There can be no refusal of ownership of property after its acceptance. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all of the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law. In the absence of facts to the contrary, if a person fails to refuse to accept a transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

*Id.* at 1476 n.4 (quoting Treas. Reg. § 25.2511-1(c), 26 C.F.R. § 25.2511-1(c) (1959)).

215. *Id.* at 1475, 1483.

216. *Id.* at 1479-80. After the audit, the taxpayer paid the associated gift tax and interest assessment and immediately sought a refund. *Id.* at 1476. After the Service denied the taxpayer's refund request, the taxpayer's estate filed a refund action in federal district court. The district court granted summary judgment to the estate concluding that imposing gift tax on the disclaimer would be tantamount to retroactive application of the gift tax statute. *Id.* at 1477. The applicable gift tax statute referred to by the district court, contained in the Revenue Act of 1932, was not enacted until 1932, well after the creation of the taxpayer's remainder interest in the trust in 1917. The Eighth Circuit, rehearing the case en banc, affirmed the district court. *Irvine*, 114 S. Ct. at 1477.

Both the district court and the Eighth Circuit read the Treasury's disclaimer regulation (referring to a "taxable transfer") literally. Accordingly, in the court's view, the interest created by the pre-1932 transfer could not have been disclaimed under the regulation because it was not taxable and, thus, could never be a "taxable transfer." *Id.* at 1477-78. Therefore, both lower courts looked to state law to determine that the taxpayer's disclaimer was effective. *Id.*

Pursuant to joint agreement of the parties, the court noted that the then-current (1986) version of the regulation superseded the earlier 1959 version. *Id.* at 1476 n.6. Section 7805(b) permitted the Secretary of the Treasury to "prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect." *Id.*; see also *Automobile Club of Mich. v. Commissioner*, 353 U.S. 180 (1957). Thus, the relevant regulation applicable to the case was § 25.2511-1(c)(2) (1993), which provided in relevant part:

The Supreme Court held that it was reversible error for the lower courts to look to state law.<sup>217</sup> Indeed, the general rule in a disclaimer case was that the disclaimer was taxable unless the Treasury's regulatory exception applied.<sup>218</sup> Accordingly, absent the regulation's applicability, the general federal (not state) law of disclaimers governed.<sup>219</sup> Thus, because either applicability or non-applicability of the disclaimer would result in gift tax liability, the high court refused to rule on the issue of whether the Treasury's regulation applied.<sup>220</sup> Notably, the issue of whether the regulation was valid never arose, except in the context of whether the regulation resulted in taxation of a transaction that pre-dated enactment of the gift tax.<sup>221</sup> However, the Court quickly dismissed this argument by pointing out that the critical transaction (the disclaimer) occurred in 1979, well after enactment of the gift tax in 1932.<sup>222</sup>

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- In the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under the local law. There can be no refusal of ownership of property after its acceptance. In the absence of the facts to the contrary, if a person fails to refuse to accept the transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property. Where the local law does not permit such a refusal, any disposition by the beneficiary, heir, or next-of-kin whereby ownership is transferred gratuitously to another constitutes the making of a gift by the beneficiary, heir, or next-of-kin. In any case where a refusal is purported to relate to only a part of the property, the determination of whether or not there has been a complete and unqualified refusal to accept ownership will depend on all the facts and circumstances in each particular case, taking into account the recognition and effectiveness of such a purported refusal under the local law.

*Id.* at 1477 n.6 (quoting Treas. Reg. § 25.2511-1(c)(2), 26 C.F.R. § 25.2511-1(c)(2) (1993)).

217. *Id.* at 1481.

218. *Id.* at 1482.

219. *Id.*

220. *Id.* at 1480.

221. *Id.* at 1481-82.

222. *Id.* at 1482.

In *Newark*,<sup>223</sup> the Supreme Court once again faced an issue of applicability, not validity, of a Treasury regulation. The issue in *Newark* concerned the depreciability of an intangible asset consisting of a customer base that was also goodwill.<sup>224</sup> The Court held that an intangible asset is depreciable where the taxpayer/owner proves that the asset has a reasonably determinable useful life.<sup>225</sup> The Court never addressed the issue of the validity of the Treasury's depreciation regulation—only whether the taxpayer proved its case that the questioned asset had a reasonably determinable useful life.<sup>226</sup>

In 1987, the Newark Morning Ledger newspaper sought a refund of income tax paid by its predecessor-in-interest, The Herald Company.<sup>227</sup> Herald paid the tax as a result of the Service's disallowance of a depreciation deduction Herald took, pursuant to section 167(a), on an intangible asset acquired by purchase in 1976.<sup>228</sup> The asset consisted of "paid subscribers" to a newspaper organization that Herald intended to merge with the following year.<sup>229</sup> The Service disallowed depreciation of the "paid subscribers" asset on the grounds that the asset was nondepreciable goodwill within the meaning of the Treasury's depreciation regulation section 1.167(a)-3.<sup>230</sup> Pursuant to that regulation, if an intangible asset is shown to have a limited useful life based on known experience or other factors *and* the

223. 507 U.S. 546 (1993).

224. *Id.* at 548.

225. *Id.* at 566.

226. *Id.* at 570.

227. *Id.* at 550-51.

228. *Id.* at 548-50. Section 167(a) provides: "General Rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) of property held for the production of income." *Id.* at 548 n.1 (quoting 26 C.F.R. § 1.167(a)-3 (1992)).

229. *Id.* at 550.

230. *Id.* Treasury Regulation § 1.167(a)-3 provides:

If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill.

*Id.* at 548 n.1 (quoting Treas. Reg. § 1.167(a)-3, 26 C.F.R. § 1.167(a)-3 (1992)).



length of that life can be reasonably estimated, the asset may be depreciable.<sup>231</sup> Further, if the asset consists of goodwill it will not be depreciable.<sup>232</sup>

In reversing the circuit court, the Supreme Court emphasized the importance of the fact that its decision was based on a factual determination, not whether the Treasury's depreciation regulation was valid.<sup>233</sup> Indeed, had the Service presented a credible case to support its litigation position, the Court might have ruled differently. However, because the Treasury interpreted its own regulation as permitting depreciation of goodwill in an "unusual case" and because the Court saw this as an unusual case, the court's ruling was consistent with the Treasury's regulation.<sup>234</sup> Thus, once again, the *Chevron* policy is not thwarted.

#### D. Determining Reasonableness Under Chevron's Step Two

*Cottage Savings Ass'n v. Commissioner*,<sup>235</sup> is another example of how the Supreme Court has abided by the *Chevron* two-step deference philosophy. In fact, *Cottage Savings* demonstrates how the Court determines, at *Chevron*'s step two, whether an agency's regulatory interpretation is reasonable.

The issue in *Cottage Savings* was whether a taxpayer's loss realized from an exchange of properties could be recognized in the year of the exchange.<sup>236</sup> The Supreme Court concluded that

231. *Id.*

232. *Id.*

233. *Id.* at 566. The taxpayer sued the Service in federal district court arguing that the intangible "paid subscriber" asset was depreciable. *Id.* at 550-51. At trial, the taxpayer presented expert testimony that the asset had a determinable useful life based on known experience and presented evidence of reasonable estimates of the length of that life. *Id.* at 551. The Service did not contest the taxpayer's expert testimony or evidence. Instead, the Service argued that the "paid subscriber" asset is indistinguishable from goodwill and, accordingly, is not depreciable. *Id.* at 551-52. After trial, the district court ruled in favor of the taxpayer, noting that the taxpayer successfully showed that the "paid subscriber" asset was separate and distinct from goodwill. *Id.* at 552. The Third Circuit disagreed with the district court on this point and reversed, noting that goodwill and "paid subscribers" are indistinguishable. *Id.*

234. *Id.* at 559.

235. 499 U.S. 554 (1991).

236. *Id.* at 557-58. In *Cottage Savings* the taxpayer, a savings association, transferred participation interests in 252 mortgages to other savings associations in exchange for participation in 305 other mortgages. *Id.* at 557. The face value of the participation interests exchanged by the taxpayer was less than the market value of the participation interests received. The taxpayer deducted the difference as a loss on

the loss deduction was permissible under section 1001(a)<sup>237</sup> and allowed by section 165(a).<sup>238</sup> The Court noted that the taxpayer's loss could only be realized, and thus deductible, if resulting from a section 1001(a) "disposition of property" transaction.<sup>239</sup> Accordingly, as a "disposition of property" transaction, as long as the adjusted basis<sup>240</sup> exceeds the amount realized,<sup>241</sup> section 1001(a) permits realization of the loss. Unless otherwise provided, the realized loss is also recognized and, presumably, deductible.<sup>242</sup>

The Court then addressed the deference issue: whether the Treasury's regulatory interpretation of the phrase "disposition of property" as used in section 1001 was reasonable, and thus, valid.<sup>243</sup> The Treasury's regulation provided that "the gain or loss realized . . . from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained."<sup>244</sup> The Commissioner argued that, pursuant to the regulation, the taxpayer's property disposition does not qualify for section 1001 realization unless

its 1980 federal income tax return. *Id.* at 558. The Commissioner disallowed the loss, but the Tax Court later held that the loss was permissible because the taxpayer had "realized" the loss within the meaning of § 1001(a) of Title 26. *Id.* at 558-59. The Court of Appeals reversed the Tax Court. *Id.* at 558. While the Circuit Court agreed with the Tax Court that the taxpayer realized the loss, it concluded that the loss was not allowable because it was not "actually" sustained in 1980 as required by § 165(a) of Title 26. *Id.*

237. *Id.* at 566. Section 1001(a) provides:

The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

26 U.S.C. § 1001(a) (1994).

238. *Cottage Savings*, 499 U.S. at 568. Section 165(a) provided a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." *Id.* at 567 (quoting 26 U.S.C. § 165(a)).

239. *Cottage Savings*, 499 U.S. at 559.

240. The "adjusted basis" for determining gain or loss from the sale or other disposition of property is "the basis . . . , adjusted as provided in section 1016". See 26 U.S.C. § 1011(a) (1994). The "basis" of property is generally "the cost of such property, except as otherwise provided. . ." See *id.* § 1012.

241. *Id.* The "amount realized" from the sale or other disposition of property is "the sum of any money received plus the fair market value of the property (other than money) received." See *id.* § 1001(b).

242. See *id.* § 1001(c).

243. *Cottage Savings*, 499 U.S. at 560-61.

244. *Id.* (quoting Treas. Reg. § 1.1001-1, 26 C.F.R. § 1.1001-1 (1990) (emphasis omitted)).

the properties exchanged are "materially different."<sup>245</sup> Justice Marshall, writing for the majority, noted that "[n]either the language nor the history of [section 1001] indicates whether and to what extent property exchanged must differ. . . ."<sup>246</sup> Therefore, the only issue for the Court in deciding whether to defer to the Treasury's regulatory interpretation of section 1001 was whether that interpretation was reasonable.<sup>247</sup>

The *Cottage Savings* Court held that the Treasury's regulation was reasonable for two reasons. First, the regulation represented a long-lasting interpretation of section 1001.<sup>248</sup> The Court noted that the original language contained in section 1001 was first placed in the Code in 1924<sup>249</sup> and that the Treasury's interpretation has consistently required materially different properties since 1934.<sup>250</sup> Second, the Treasury's interpretation was consistent with Supreme Court precedent from the 1920's indicating that the properties exchanged must be "materially" or "essentially" different.<sup>251</sup>

At first blush, these two bases for determining the reasonableness of the regulation appear to be a reversion to the pre-*Chevron* era when courts looked at various factors to establish a regulation's validity.<sup>252</sup> However, recall that the *Chevron* Court never disavowed the pre-*Chevron* factors. Instead,

245. *Id.* at 560.

246. *Id.*

247. *Id.* at 560-61.

248. *Id.* at 561.

249. *Id.* at 561; see The Revenue Act of 1924, ch. 234, 43 Stat. 253, § 202(a).

250. Treas. Reg. 86, Article 111-1, promulgated pursuant to the Revenue Act of 1934, provided: "[e]xcept as otherwise provided, the Act regards as income or as loss sustained, the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent." *Id.* at 560 n.6 (quoting Treas. Reg. 86, art. 111-1 (emphasis omitted)).

251. *Id.* at 562. The court cited the following cases: *United States v. Phellis*, 257 U.S. 156, 173 (1921); *Weiss v. Stern*, 265 U.S. 242, 253-54 (1924); and *Marr v. United States*, 268 U.S. 536, 540-42 (1925). *Id.*

252. See, e.g., *Coverdale*, *supra* note 5, at 59.

In *Cottage Savings Ass'n v. Commissioner*, the Commissioner requested *Chevron* deference for a general authority regulation. The Court neither applied *Chevron* nor held that it was inapplicable, but simply ignored the request. Instead, it cited a classic tax deference case, *National Muffler Dealers Ass'n v. United States*, for the proposition that courts must defer to general authority regulations because Congress has entrusted the administration of the tax laws to the Commissioner. The Court also invoked the doctrine that long-standing regulations merit special deference when Congress has reenacted the underlying statute.

*Id.* (footnotes omitted).

the *Chevron* Court merely adjusted the manner in which reviewing courts use those factors. Consistent with that adjustment, the Court in *Chevron* merely concluded that, absent contrary congressional direction, an administrative interpretation of a statute will be upheld if permissible and reasonable.<sup>253</sup> Thus, reference to long-standing interpretations that appear acceptable to Congress and reliance on historical court precedents are legitimate means of establishing the reasonableness of an interpretation.

Notably, the Court in *Cottage Savings* did not defer to the Treasury's non-regulatory interpretation of what constitutes a material difference for purposes of section 1001(a).<sup>254</sup> Instead, the Court looked to other authorities (for example, court precedent) to establish what "material difference" requires.<sup>255</sup> This is consistent with this Article's contention that *Chevron* deference only applies to regulatory interpretations of congressional enactments. Thus, as in *Cottage Savings*, an agency's "in-court" or other nonregulatory interpretations are not entitled to *Chevron*-type deference. As such, a court faced with nonregulatory interpretations is free to disregard those interpretations without going through the *Chevron* two-step.

### CONCLUSION

This Article began with the notion that *Chevron* signaled a major occurrence in administrative law jurisprudence. Indeed it has. *Chevron* demonstrates that courts and agencies can co-exist in an ever-changing and growing democratic world. The need for agencies as interpreters of the law is not obviated by the role of courts as judicial arbiters. As indicated by both pre-*Chevron* and post-*Chevron* decisions, courts will always have the final say when it comes to areas of general legal knowledge, not necessarily requiring any nonlegal experiential insights. However, in cases when the experience of an administering agency is helpful, the *Chevron* framework permits peaceful co-existence by permitting the agency's views to guide the way.

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253. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, 865 (1984).

254. *Cottage Savings*, 499 U.S. at 562.

255. *Id.* at 562-67.

While this Article may have begun with visions of fondness with respect to *Chevron*, it is all too apparent that those visions are somewhat blurred by the noticeable absence of references to *Chevron* by the Supreme Court. Perhaps the high court recognizes that *Chevron* signaled something special, but wants to emphasize that much of what lead up to *Chevron* is alive and well? or perhaps the high court has other reasons for failing to at least note in reference that *Chevron* does or does not apply in certain situations? Nevertheless, the Court's allegiance to *Chevron*—when relevant—is clear.

With respect to Treasury regulations, *Chevron* merely sharpens the notions that existed prior to 1984. Tax regulations that interpret terms not already defined by statute or legislative history will likely be upheld against a claim of invalidity. On the other hand, tax regulations that interpret terms that have already been defined by Congress are less likely to survive judicial scrutiny and will likely be invalidated if challenged. Thus, as was the case before *Chevron*, the absence, or presence, of a congressional interpretation of a statutory term that an agency interprets and defines by regulation is critical to deciding if the regulation is a valid exercise of rule-making power. The Court determines in the first instance if the definition is present. If not present, the Treasury is free to impose its reasonable "tax" will. However, the Court decides in the second instance if that will is reasonable.